(16)

In The Supreme Court

OF THE

United States

OCTOBER TERM, 1942

No. 524

MILLER LAND AND LIVESTOCK CO.,
Petitioner,

vs.

FRANK BOGART,
Respondent.

Brief for Respondent

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MISSTATEMENT OF FACTS IN PETITION AND BRIEF FOR PETITIONER.

In the opinion of the lower court it is said:

"It is to be gathered from the record that approximately $200,000 of unsecured claims were approved in the proceeding. The precise amount of the secured debts, aside from that owing appellant, is not shown; but it does appear that there is at least one other secured claim, amounting to $9,300 and bearing interest at the rate of 9%." (129 Fed. (2d) 774).

On page 2 of the Petition it is stated that all secured creditors, except Frank Bogart, Respondent, "had waived claims for interest" and reference is made to page 55 of the record in support of this statement.

In the brief for petitioner, on page 11, it is said:

> "The record does show that:
>
> a. That all secured claimants, except Mr. Bogart, had waived all interest" etc.

In the brief for petitioner, on page 14, there is a quotation from page 55 of the record as follows:

> "That all of said creditors have waived their claims for interest and have discounted the face of their claims for various amounts."

It is stated that in this quotation the words "said creditors" referred to the "secured creditors", and that in the majority opinion of the lower court this fact was completely "overruled", apparently intending to state that it was overlooked.

That the words "said creditors" did not refer to Abbott & Company clearly appears from the prayer of the "Return to Order to Show Cause", on page 57 of the record, in which the petitioner prays that not only the interest on the Bogart claim be reduced, but also the interest on the Abbott & Company claim be reduced. Furthermore, in the affidavit of the attorney for the petitioner, made a part of the record (p. 115) it is stated that at the time of the petition for the reduction of interest on the Bogart claim there were several secured claims which "had not been disposed of, among which was the claim

of Abbott & Company for $9807.15". It further appears from the affidavit that the Abbott & Company claim was settled for an amount which included interest "to below four per cent", after the making of the order reducing the interest on the Bogart claim.

It is immaterial, however, whether there had been a settlement of the Abbott & Company claim at the time of the making of the order in question, as the record shows that at the time of the making of the order there were approximately $200,000 of unsecured claims which had been approved in the proceeding (R. 64). By the proposal made, the acceptance of same by the creditors and the confirmation by the court, the petitioner had agreed to pay the unsecured creditors 5% interest on their claims.

SUBDIVISION (k) OF SECTION 75 OF THE BANKRUPTCY ACT ONLY AUTHORIZES REDUCTION OF FUTURE RATE OF INTEREST ON ALL DEBTS.

The language of the proviso in Subdivision (k) of Section 75 of the Bankruptcy Act is that:

> "nothing herein shall prevent the reduction of the future rate of interest on *all debts* of the debtor, whether secured or unsecured." (Italics ours.)

The authority thus conferred is authority to reduce the rate of interest on "all debts" and not on one of many debts.

It is unreasonable to suppose that it was intended

that the Court might discriminate between creditors in the matter of reducing interest.

DISSENTING OPINION IN LOWER COURT

It should be noted that the dissenting opinion in the lower court does not discuss the reason assigned in the majority opinion for declaring the order reducing interest on the Bogart claim invalid. The dissenting opinion is confined solely to the contention that to construe the statute as authorizing a reduction in the rate of interest, under the circumstances of this case, would render the same unconstitutional, which the majority of the court did not consider.

TO CONSTRUE THE STATUTE AS AUTHORIZING THE ORDER IN QUESTION WOULD RENDER THE SAME UNCONSTITUTIONAL.

The Bogart claim was approved and allowed for $150,000, with interest at 6% per annum, the contract rate. By the proposal, the petitioner agreed to pay this interest and it is admitted that the property securing the payment of the claim is worth several times the amount of the claim. The petitioner acquired the property subject to the mortgages, without agreeing to pay the indebtedness. The claim, therefore, was solely against the property.

A secured creditor has the same right to interest as he has to the principal of his claim, where the security is ample.

In the case of *Ticonic National Bank v. Sprague*, 303 U. S. 406, 82 L. Ed. 926, this court said:

"This Court has already held that a lienholder may look to his lien not only for the principal but also for interest accruing up to the date of payment, though his debtor has gone into bankruptcy" (Citing *Coder v. Arts*, 213 U. S. 223, 245, 53 L. Ed. 772, 782).

See also:

Mortgage Loan Co. v. Livingston, 45 Fed. (2d) 28;

In re Hagin, 21 Fed. (2d) 433;

San Antonio L. & T. Co. v. Booth, 2 Fed. (2d) 590.

In foot note No. 31 to the case of *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 79 L. Ed. 1593, in which the original Frazier-Lemke Act was held unconstitutional, it is said:

"Counsel for the debtor suggests that the reasonable rental provided for in paragraph 7 is more than the secured creditor ordinarily receives in bankruptcy, since interest on secured as well as unsecured claims ceases with the filing of the petition. But the rule relied upon applies only when the secured creditor, having realized upon his security, is seeking as a general creditor to prove for the deficiency against the bankrupt estate. *Sexton v. Dreyfus*, 219 U. S. 339, 55 L. Ed. 244, 31 S. Ct. 256, 25 Am. Bankr. Rep. 363. It has no application when the mortgagee has a preferred claim against proceeds realized by the trustee from a sale of the security free of liens." (Citing *Coder v. Arts*, 213 U. S. 223, and other cases).

In the case of *Bartels v. John Hancock Mutual Life Insurance Co.*, 100 Fed. (2d) 813, which involved a

consideration of the Frazier-Lemke Act, as amended, the court said:

> "But secured creditors whose liens antedate the law have as to their security vested rights which must be effectuated."

In the same case, 308 U. S. 180, 84 L. Ed. 176, this court said:

> "The scheme of the statute is designed to provide an orderly procedure so as to give whatever relief may properly be afforded to the distressed farmer-debtor, while protecting the interests of his creditors by assuring the fair application of whatever property the debtor has to the payment of their claims, *the priorities and liens of secured creditors being preserved.*" (Italics ours).

It was because the Frazier-Lemke Act, as originally enacted, authorized the taking of the property of the mortgagee, in violation of the Fifth Amendment to the Federal Constitution, that the statute was declared unconstitutional.

> *Louisville Joint Stock Land Bank v. Wm. W. Radford*, 295 U. S. 555, 79 L. Ed. 1593.

It appeared in that case that Radford had mortgaged his farm to the Louisville Joint Stock Land Bank long prior to the enactment of the Frazier-Lemke Act. In the opinion in the case this court said:

> "No instance has been found, except under the Frazier-Lemke Act, of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full.
>
> This right of the mortgagee to insist upon full

payment before giving up his security has been deemed of the essence of a mortgage."

This court further said:

"It is true that the position of a secured creditor, who has rights in specific property, differs fundamentally from that of an unsecured creditor, who has none; and that the Frazier-Lemke Act is the first instance of an attempt, by a bankruptcy act, to abridge, solely in the interest of the mortgagor, a substantive right of the mortgagee in specific property held as security. * * * * * Because the Act is retroactive in terms and as here applied purports to take away rights of the mortgagee in specific property, another provision of the Constitution is controlling.

Fourth. The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contracts. Compare *Mitchell v. Clark*, 110 U. S. 633, 643, 28 L. Ed. 279, 282, 4 S. Ct. 170, 312. But the effect of the Act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the Bank prior to the Act. In order to determine whether rights of that nature have been taken, we must ascertain what the mortgagee's rights were before the passage of the Act. We turn, therefore, first to the law of the State."

This court then discusses the law of Kentucky

and, referring to the Frazier-Lemke Act, said:

> "As here applied it has taken from the Bank the following property rights recognized by the law of Kentucky:
>
> 1. The right to retain the lien until the indebtedness thereby secured is paid."

In the case of *Wright v. Mountain Trust Bank*, 300 U. S. 440, 81 L. Ed. 736, in which this court had under consideration the Frazier-Lemke Act as amended, it is said:

> "It is not denied that the new Act adequately preserves three of the five above enumerated rights of a mortgagee. 'The right to retain the lien until the indebtedness thereby secured is paid' is specifically covered by the provisions in paragraph 1, that the debtor's possession, 'under the supervision and control of the court', shall be 'subject to all existing mortgages, liens, pledges, or encumbrances', and that:
>
> 'All such existing mortgages, liens, pledges, or encumbrances shall remain in full force and effect, and the property covered by such mortgages, liens, pledges, or encumbrances shall be subject to the payment of the claims of the secured creditors, as their interests may appear'."

In the case of *Wright v. Union Central Life Insur. Co.*, 311 U. S. 273, 85 L. Ed. 184, in discussing Section 75 of the Bankruptcy Act, the court said:

> "Safe-guards were provided to protect the rights of secured creditors throughout the proceedings to the extent of the value of the property."

The court further said:

> "And the creditor will not be deprived of the assurance that the value of the property would be devoted to the payment of its claim."

As the property mortgaged is ample security for the payment of the mortgage debt, interest is collectible at the contract rate to the time of payment of the indebtedness, and is secured by the lien of the mortgage the same as the principal of the debt.

Bogart, by virtue of the lien of his mortgages, is the owner of an interest in the mortgaged property equal to the principal and interest of his claim, and, as the value of the mortgaged property is greatly in excess of his claim, the effect of the reduction of the interest is to take his property to the extent of the difference between the contract rate of interest and the reduced rate and give it to the debtor or the unsecured creditors, in violation of the Fifth Amendment to the Federal Constitution.

CONSTRUCTION OF SUBDIVISION (k)

Reading Subdivision (k) in the light of the decisions of this Court hereinbefore cited, in which it was decided that where the property mortgaged is ample security for the payment of the mortgage debt, the right of the mortgagor to the payment of his debt in full is a right protected by the Fifth Amendment to the Federal Constitution, the concluding words that "nothing herein contained shall prevent the reduction of the future rate of interest on all debts of the debtor, whether secured or unsecured" can only apply to a secured debt where the

security is insufficient and the creditor is entitled to participate with the unsecured creditors, as in the case of *Sexton v. Dreyfus,* 219 U. S. 339, 55 L. Ed. 244. Such a construction harmonizes these words with the express declaration "that such extension and/or composition shall not reduce the amount of, or impair the lien of any secured creditor below the fair and reasonable market value of the property securing any such lien at the time the extension and/or composition is accepted".

To construe the concluding words of Subdivision (k) as authorizing the Court to reduce the rate of interest, where the debt does not exceed "the fair and reasonable market value of the property", and the debtor is not personally liable would clearly render the statute unconstitutional in view of the decision in the Louisville Joint Stock Land Bank case, 295 U. S. 555, 79 L. Ed. 1593.

PROPOSAL OF PETITIONER (DEBTOR) WAS FOR AN EXTENSION AND NOT FOR A COMPOSITION.

In the proposal of the debtor (Record p. 2) it is stated:

"Debtor proposes to pay all creditors in full."

It is further stated that the unpaid balances on the claims of the secured creditors "to bear interest at the existing contract rate". (R. p. 3).

This is not a proposal for composition but a proposal for extension. The proposal was for an extension of time to pay all creditors in full. The distinction between a composition and an extension

proposal is discussed in the case of *Heldstab v. Equitable Life Assurance Society*, 91 Fed. (2d) 655. The court in the opinion in that case said:

> "Composition by creditors with their debtor in bankruptcy is an agreement between them that the latter will pay down and the former will accept a named per cent of their claims in full satisfaction. * * * *An extension proposal is an agreement on the part of the creditors* that they will extend the time within which their claims *are probably to be paid, in full, as to secured creditors on the terms proposed by the debtor and approved by the court.*" (Italics ours).

Petitioner refers to Subdivision (1) of Section 75 of the Bankruptcy Act as authorizing the order in question. This Subdivision recognizes the distinction between an extension proposal and a composition proposal and provides that the court may "modify the terms of the extension proposal".

Considering the distinction between a composition proposal and an extension proposal, we submit that the authority granted by Subdivision 1 "to modify the terms of the extension proposal" does not authorize the Court to substitute for the extension proposal a composition proposal which would be the effect of permitting the debtor to discharge his property from the lien of the mortgages securing the Bogart claim, by paying less than the amount agreed to be paid.

CASE OF COHAN V. ELDER, 112 FED. (2d) 967.

Petitioner, as one of the reasons relied upon for

the allowance of the writ, says that the Circuit Court of Appeals "Has held both ways on identical questions", citing the case of *Cohan v. Elder* (pp. 7 & 8 of Petition).

In the majority opinion of the lower court, (129 Fed. (2d) 774) referring to the case of *Cohan v. Elder*, in a foot note it is stated:

> "The proposal there made by the debtor for the reduction of interest affected all creditors alike."

It is further stated that:

> "Doubts suggested here were not urged or considered" in that case, having reference to the constitutional question.

* * * * * * * * *

The petition should be denied.

Respectfully submitted,

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